

No. 14221

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**In the United States Court of Appeals  
for the Ninth Circuit**

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**ALICE E. COHN, MARION A. COHN, DANIEL E. COHN AND  
EDGAR M. COHN, PETITIONERS**

*v.*

**COMMISSIONER OF INTERNAL REVENUE, RESPONDENT**

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***ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX  
COURT OF THE UNITED STATES***

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**BRIEF FOR THE RESPONDENT**

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**OPINION BELOW**

The findings of fact and opinion of the Tax Court (R. 17-45) are reported at 21 T.C. No. 11.

**JURISDICTION**

The petitions for review (R. 49-51, 374-375) <sup>1</sup> involve deficiencies in income taxes determined by the Commissioner against the taxpayers for the calendar years 1945

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<sup>1</sup> Due to the factual similarity in these cases, it was stipulated that, except for the decisions (R. 45-48), the record should contain the proceedings, documents, etc., only in the case of Edgar M. Cohn. While statements in the brief will refer to all taxpayers, record references will cover only one case. (R. 374-375.)

and 1946. On September 27, 1949, the Commissioner mailed the taxpayers notices of deficiencies in taxes for those years. (R. 5, 8.) Within 90 days thereafter and on October 31, 1949, the taxpayers filed petitions with the Tax Court of the United States for a redetermination of the deficiencies in income taxes for the calendar years 1945 and 1946 (R. 3, 5-7), under Section 272 (a) (1) of the Internal Revenue Code. The decisions of the Tax Court that there were deficiencies in income taxes for the years 1945 and 1946 were entered on October 26, 1953 (R. 45-48), and the case is brought to this Court by petitions filed December 28, 1953. (R. 4, 49-51).

↪Jurisdiction is conferred on this Court by ~~(R. 4, 49-51)~~ of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

#### QUESTION PRESENTED

Whether there is sufficient evidence in the record to support the Tax Court's finding that the 69 multiple unit houses in question were held during 1944 and 1945, primarily for sale to customers in the ordinary course of the partnership's business within the meaning of Section 117 (a) and (j) of the Internal Revenue Code and as a result were not capital assets, so that the gain realized in 1945 and 1946 on the installment basis, from their sale in 1945, constituted ordinary income rather than long-term capital gain.

#### STATUTE AND REGULATIONS INVOLVED

The applicable statute and Regulations are set forth in the Appendix, *infra*.

## STATEMENT

The facts as stipulated and as found by the Tax Court (R. 19-35) are as follows:

Edgar and Marion Cohn, and Daniel and Alice Cohn are, each, husband and wife. Edgar and Daniel are brothers. Daniel and Alice Cohn were married on June 5, 1945. All were residents of California during the taxable years, and each filed a separate income tax return for 1945 and 1946 in which income was reported on a community property basis. For convenience, Edgar and Daniel are referred to hereinafter as the taxpayers. (R. 19.)

The taxpayers are the sons of Max Cohn. Max Cohn and the taxpayers owned the stock in the corporation, Security Construction Company, Inc., which, in 1941, subdivided land in the area "Beautiful Glenwood," near Burbank, and built thereon 66 single family houses. The houses were held for sale to customers and they were sold in 1941 and 1942 upon completion. Tracts of land which are numbered 13170, 13171, and 13172 are involved in these proceedings and they are adjacent to and near the tract on which the corporation built 66 houses for sale in 1941. (R. 19.)

On May 21, 1942, Edgar and Daniel formed a partnership, Security Construction Company, referred to hereinafter as "the partnership," in which they were equal partners. The business of the partnership in its income tax returns for the years 1942 to 1946, inclusive, is stated to be "real estate"; and the business of the taxpayers in their individual returns for 1945 and 1946 is stated to be "real estate." (R. 20.)

The partnership acquired tract number 13172, as acreage, on May 25, 1942. It acquired tract number

13170, subdivided into 56 lots, on September 28, 1943. It acquired tract number 13171, subdivided into 132 lots, on January 21, 1944. The three tracts of land were acquired from Max Cohn. They are located about three-quarters of a mile from the Lockheed Aircraft Corporation plant. (R. 20.)

The partnership engaged in its business from May 21, 1942, until about April 1, 1946, after which date it was inactive. During the period of active business in the years 1942 to 1946, inclusive, the partnership built and sold 324 houses, of which 253 were single-unit houses and 71 were multiple-unit houses. Prior to their sale, 69 of the multiple-unit houses, which are involved in these proceedings, were rented. The net profit from sales and the net rents received by the partnership in the years 1942 to 1946 were as follows (R. 20, 21):

Year	Houses Sold	Single Units Sold	Multiple Units Sold	Net Profit, Sales	Net Rents
1942.....	21	21	-0-	\$ 15,035	-0-
1943.....	109	109	-0-	73,349	-0-
1944.....	109	109	-0-	111,436	\$28,793
1945.....	69	-0-	69	238,329	8,425
1946.....	16	14	2	64,835	745
Total.....	324	253	71	\$502,984	\$37,963

By August 26, 1942, tract 13172 was subdivided by the partnership into 132 lots. During 1942 and 1943, the partnership built 130 single family houses in that subdivision. All of the houses were sold immediately upon completion: 21 houses were sold in 1942 for a net profit of \$15,035; and 109 houses were sold in 1943 for a net profit of \$73,349. All of these houses were built for sale to customers in the ordinary course of the partnership's business. The partnership reported the gain from the sales as ordinary income, on the installment basis. The sales of the houses were made by a real es-



tate broker who devoted his full time to the work, with the help and cooperation of the partnership. The broker received a commission of \$30 for each house hold. The partnership bought two buildings adjoining the tract in 1941 and 1942, for the transaction of business, which it kept until 1946. Edgar Cohn and various real estate brokers used these buildings in their work. (R. 21.)

During the war years Edgar Cohn made continuous inquiries of the local offices of the Federal Housing Administration (F.H.A.) about the availability of priorities for the construction of houses in the area where the partnership was building houses. He learned in the early part of the summer of 1943 that F.H.A. planned for the building of about 1,000 units of defense housing in the San Fernando Valley where tracts 13170 and 13171 are located, and he intended applying for permits to build more single family houses on tract 13170. However he was advised at that time that priorities would be granted for multiple-unit houses only. He, therefore, made application for authorization to build multiple-unit houses. (R. 21-22.)

Effective February 5, 1943, the National Housing Administration (N.H.A.) issued regulations relating to the construction of defense housing which controlled the occupancy and sale thereof. These regulations applied to private war housing begun on or after February 10, 1943, and they were in force, with some revisions and amendments until some time in October, 1945, when they were revoked. (R. 22.)

Under the N.H.A. regulations effective February 5, 1943, private war housing had to be held for rental only to eligible war workers for the duration of the national

emergency, and, except for involuntary transfers, could be disposed of only in the following manner (R. 22-23):

An occupant, after 4 months' occupancy, could purchase a private war housing unit occupied by him. A person who would not himself occupy such housing could purchase such housing at any time, in accordance with N.H.A. regulations, provided that the N.H.A. limitations applicable to such housing, relating to occupancy and disposition, before such purchase should continue to be applicable after the purchase. Furthermore, at any time after 60 days after completion of any private war housing, the owner could petition N.H.A. to permit such housing to be disposed of in some way other than the pertinent regulations prescribed.

The partnership's application to F.H.A. to build multiple-unit houses in tract 13170 was granted on July 17, 1943, when it was authorized to build 23 four-unit, and 33 two-unit houses, i.e., 56 houses comprising 158 dwelling units, and by War Production Board (W.P.B.) priorities, materials were issued. Construction was not started until early in October, 1943. Before construction was started, amendments of the N.H.A. regulations applicable to private war housing became effective. Also, before construction of the 56 houses started, the partnership made application to F.H.A. for authorization to construct private war housing on tract 13171. (R. 23.)

N.H.A. General Order 60-3B (R. 184-194), effective as of August 25, 1943, amended N.H.A. General Order 60-3 (R. 175-183), by permitting an owner of war housing units to sell to war workers, within 15 days of completion and without first renting the units, one-third of

all war housing units placed under construction by the owner in any war housing area. It also permitted the sale of any war housing unit to a war worker occupant after the unit had been rented for two months. There was no change in the provisions of the prior order permitting an owner to sell war housing units, at any time, to a purchaser who would abide by the N.H.A. regulations relating to the occupancy and disposition of war housing units. (R. 23-24.)

Prior to September, 1943, Edgar Cohn was aware of the new N.H.A. Order 60-3B amending the earlier order. He intended applying for authorization to build houses on tract 13171, and knew that he could apply to N.H.A. to recognize the partnership's construction on the two tracts 13170 and 13171 as one project, and that by treating all the construction as one project he could sell one-third of the houses upon completion, provided they were sold within 15 days. Also, by September, 1943, N.H.A. was authorizing construction of single unit houses. (R. 24-25.)

In September, 1943, before construction of the 56 multiple-unit houses, the partnership filed application with F.H.A. to build 13 four-family houses comprising 52 units, and 109 single-unit houses, a total of 161 dwelling units. The applications were approved; priorities were issued on December 17, 1943. The partnership, then, was authorized to construct 178 houses comprising 319 units of which one-third, roughly 109, could be sold upon completion.<sup>2</sup> The remaining two-thirds, compris-

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<sup>2</sup> The 69 multiple-unit houses comprised 210 dwelling units. The total housing authorized, comprised 319 dwelling units of which 109 were the single family houses. It appears that N.H.A. gave its approval of treating 109 units as one-third, and 210 units as two-thirds of the project built on tracts 13170 and 13171.

ing the 69 multiple-unit houses, 210 units, would have to be held for rental to eligible war workers, either by the partnership or its transferee. (R. 25-26.)

In October, 1943, the partnership began construction of the 56 multiple dwelling houses on tract 13170. In March, 1944, the partnership started construction on tract 13171 of the 13 multiple dwelling houses and the 109 single family houses. Construction of all the houses was completed in 1944, as follows (R. 26):

Tract 13170	Completion Date
16 multiples completed by.....	2/14/44
17 multiples completed by.....	3/ 8/44
10 multiples completed by.....	3/28/44
13 multiples completed by.....	4/25/44
—	
56	

#### Tract 13171

13 multiples completed by.....	6/14/44
109 singles completed by.....	9/ 1/44

The partnership sold all of the 109 single family houses to eligible war workers immediately upon completion. The sales were made during the months of July, August, and September, 1944. The partnership advertised the houses for sale. A real estate broker sold the houses, receiving a commission of \$60 for each sale. Edgar Cohn assisted the broker in making the sales. The net profit realized from the sales amounted to \$111,-436. The profit was reported by the partnership in its return for 1944 as ordinary income, on the installment basis. (R. 27.)

The 56 multiple dwelling units on tract 13170 were gradually completed in the Spring of 1944, before all of

the single family houses were finished. The 13 multiple-unit houses on tract 13171 were completed by June 14, 1944, which, also, was before the 109 single-unit houses were completed, and before the first sales of the single-unit houses were made, which sales began in July, 1944. The partnership rented the 210 units in the 69 multiple-unit houses, as they were completed. The units were rented under one year written leases which contained a renewal clause. Under regulations of the Office of Price Administration (O.P.A.), in existence in 1944, the first and the last month's rent could be collected from a tenant only if a one year lease was given. In 1944, the partnership received gross rentals of \$92,437.20 but the net rental amounted to \$28,793 after payment of various expenses and finance charges. In the partnership return for 1944, depreciation on the multiple-unit houses was taken at the rate of four percent per annum. (R. 27.)

Edgar Cohn managed all of the activities of the partnership. Daniel Cohn was in the military service during 1944 and 1945 until his discharge on October 29, 1945. (R. 28.)

In the latter part of December, 1944, Edgar Cohn discussed with his advisors, the matter of selling the 69 multiple-unit houses. A decision was made to proceed actively to sell them, and in the early part of January, 1945, the partnership listed the multiple-unit houses with two separate real estate brokers, Leon Hahn, and Huff & Clair, who were to sell them on a commission basis of \$300 for a four-unit house, and \$150 for a two-unit house. The first sale was made on January 10, 1945. These two firms sold eight of 69 houses during January and early February of 1945. Edgar Cohn con-

sidered that the sales were proceeding too slowly, and on February 13, 1945, the partnership made an exclusive, 90-day agreement to sell the remaining 61 houses with another real estate broker named Field. The agreement was renewable for 90 days if one-half of the houses were sold within the first 90 days. Ray McKee, working for Field, devoted most of his time to selling the houses and by October 31, 1945, the 61 multiple houses were sold. Under the exclusive sales agreement with Field, the partnership was to receive a net amount for each house sold and Field was to receive the regular commission of five percent of the sales price, or anything above the stipulated net amount required by the partnership. The purchaser was to make a down payment. The difference between the down payment and the F.H.A. mortgage on each house sold was to be carried under a contract with the partnership, providing for monthly payments to the partnership until the amount due under the contract was paid in full. When that point was reached, the F.H.A. would substitute the buyer as the mortgagor, and the buyer would receive the deed held until then in escrow. (R. 28-29.)

The 69 multiple-unit houses were sold during a period of ten months, as follows (R. 29):

Month	Units Sold	Month	Units Sold
January .....	4	June .....	6
February .....	5	July .....	2
March .....	11	August .....	7
April .....	12	September .....	4
May .....	11	October .....	7
		Total .....	69

The four-unit houses were sold at prices ranging from \$14,350 to \$16,900. The two-unit houses were sold at

prices ranging from \$8,100 to \$8,950. The purchasers of all of the 69 houses took them subject to the N.H.A. regulations as to occupancy and disposition which were still in effect. Existing leases were assigned to the purchasers. (R. 29.)

The 69 multiple-unit houses were rented, prior to the sales, for a period of 12 to 14 months, on an average. The shortest period any house was rented, before sale, was about nine months; and the longest period any house was rented was about 20 months. During 1945, when vacancies occurred in the multiple-unit buildings, the partnership rented the units on an oral month-to-month basis. No written leases with new tenants were made in 1945. When the multiple-unit houses were sold, however, some of the original tenants were still occupants. Usually, re-rentals were made without a period of vacancy intervening between tenants. The partnership did not have any difficulty renting units that became vacant during 1945 while the houses were up for sale. During 1945, the partnership received gross rental of \$45,841, and net rental income of \$8,425. (R. 29-30.)

The partnership realized a net profit of \$238,329 from the sales in 1945 of the 69 multiple-unit houses. The profit was reported by the partnership in its returns for 1945 and 1946 on the installment basis as long term capital gains. (R. 30.)

In 1945, Edgar Colm spent about 65 percent of his time looking for new locations to build, and about 35 percent of his time in his office. (R. 30.)

Early in the summer of 1945, the partnership applied for and received authorization from F.H.A. and priorities from W.P.B. to construct 14 single-family houses, and <sup>two</sup> two-unit houses in Pasadena. Construction

started in August, 1945, and was completed during the first three months of 1946. The N.H.A. restrictions on occupancy and disposition of war housing units were removed in October, 1945. All of the houses were sold upon completion. The sales were made by real estate brokers on a commission basis. The partnership realized a net profit of \$64,835 from the sales, which was reported as ordinary income on an installment basis. (R. 30.)

In 1946, the partnership received income of \$745 from the rental of some small building or buildings other than the buildings located in the Pasadena project. Also, in 1946, the partnership sold five unimproved lots for a gain of \$3,618.25, which it reported as ordinary income. (R. 31.)

In the 1944 partnership return, aside from income from sales and rental, the only other income items listed are interest income of \$3,685.16 and forfeiture income of \$25. In the 1945 partnership return, aside from income from sales and rental, the only other income items listed are interest income of \$5,882.25 and forfeiture income of \$150. In the 1946 partnership return, aside from income from sales, the only other income items listed are interest income of \$7,794.36, rent of \$745, and miscellaneous income of \$53.14. (R. 31.)

All of the houses built by the partnership, single and multiple-unit houses, were financed as Title VI, F.H.A., 25-year, four and one-half percent, mortgage loans on individual houses and lots through the Glendale Federal Savings & Loan Association. (R. 31.)

From 1946 to December, 1951, Edgar and Daniel Cohn formed additional corporations for the purpose of building houses for sale. Houses built by these corpora-



tions, owned by the Cohn brothers, during this period include the following (R. 31-32):

Security Construction Company, Inc., was organized in 1941. In 1948 and 1949 it built and sold 365 single houses in Hawthorne, Lawndale and Torrance.

Keswick Corporation was organized in 1946. In 1946, it built in Toluca Lake, near Warner Brothers Studio, 12 four-unit houses which it rented and then sold in 1947, 1948, and 1949.

Orange Gardens was organized in 1947. In 1947 it built 11 apartments in North Long Beach, about 7 miles from the ocean. The apartments were rented immediately and are still rented. In 1950 it built and sold 124 single houses in Redondo.

D & E Corporation was organized early in 1946. It acquired land in Hawthorne, near Inglewood. In 1946 and 1947, it built and sold 84 single houses. In 1949 and 1950, it built and sold 59 single houses in Pacific Palisades. In 1950 and 1951, it built and sold 202 single houses in Redondo. In 1951, it was building 80 single houses.

Bonnie Brae Gardens was organized in 1947. In 1947 and 1948, it built 13 multiple-unit houses containing 46 apartment units in the Westlake area, near downtown Los Angeles. The apartments were rented and then sold in 1949 and 1950.

In addition to the above, Edgar and Daniel Cohn had a one-half interest in a partnership known as Construction Enterprises, organized in 1951, which partnership built 72 houses in the San Fernando Valley and sold them upon completion. (R. 32.)

From 1941, to December, 1951, Edgar and Daniel Cohn, through their various corporations and partnerships, have built at least 1,332 single- and multiple-unit houses. Of the buildings constructed, 1,225 were single family houses, and all were sold immediately upon completion. At least 107 of the buildings constructed were multiple houses. The only multiple-unit houses built by taxpayers, not sold, but still rented, are the 11 apartment buildings built by the Orange Gardens Corporation in North Long Beach. These 11 apartments are located near the ocean, about 35 miles from the 69 multiple houses sold in 1945, which, here, are in controversy. (R. 32-33.)

At least in January, 1944, Edgar Cohn was advised by the partnership's accountant about the Internal Revenue Code definition of capital assets, that in order to report gain from the sale or exchange of a capital asset as long term gain, the capital asset must be held more than six months, and that property held for sale to customers in the ordinary course of a trade or business is excluded from the Code definition of capital assets. The partnership's accountant pointed out to Edgar Cohn, that even though the partnership rented the multiple-unit houses constructed on tracts 13170 and 13171, if they were sold, a question might arise whether they were held for sale to customers or were capital assets, and the accountant, who took care of taxation matters for the partnership, advised Edgar to send him a letter "stating that they had determined to hold the buildings for investment so that there would be no question about it in the future if sale occurred." Edgar Cohn complied with the accountant's advice by sending him a letter dated January 12, 1944. (R. 33, 220-221.)

The ultimate findings of the Tax Court are as follows (R. 34-35):

Prior to and during the taxable years, Security Construction Company—the partnership—was engaged in the business of building houses for sale. It did not, in 1944 or 1945, enlarge or change its business to that of renting residential property for investment, or enter into a new business of renting property to defense workers.

It was originally intended to construct the 69 multiple-unit houses for sale under N.H.A. regulations, as well as the 109 single-unit houses. The 109 single-unit houses and the 69 multiple-unit houses constituted a single defense housing project, and the construction of the 69 multiple-unit houses was necessary in order to sell upon completion, without first renting, the 109 single-unit houses. The renting of the 69 multiple-unit houses was required by N.H.A. regulations and was only incidental to selling them. The 69 houses were held during 1944 and 1945 primarily for sale to customers in the ordinary course of the partnership's business of building and selling houses. They were rented only until it was profitable to sell. The 109 single-unit houses were held primarily for sale to customers in the ordinary course of the partnership's business of building and selling houses.

The 69 multiple-unit houses were not capital assets. The gain realized in 1945 and 1946, on the installment basis, from the sale thereof in 1945 constituted ordinary income rather than long-term capital gain.

## SUMMARY OF ARGUMENT

The sole question presented in this case is whether the profit realized from the sale of the 69 multiple unit houses in 1945 should be taxed as ordinary income or as capital gain. The profit should be taxed as ordinary income if the houses were held by the taxpayers primarily for sale to customers in the ordinary course of the partnership's business within the meaning of Section 117 (a) and (j) of the Internal Revenue Code. The Tax Court found that the 69 units in question here were held by the partnership in 1944 and 1945 primarily for sale to customers in the ordinary course of its business of building and selling houses, and therefore the gain realized on their sale was taxable as ordinary income. Whether the property was so held is, of course, a question of ultimate fact, no single circumstance being conclusive, and the Tax Court's finding to that effect should not be disturbed unless clearly erroneous. Therefore, we need only determine whether that finding is supported by the record.

Taxpayers contend that they were in the dual business of building houses for sale and rental. However, we submit that in the light cast by the Tax Court's application of the various guides, which have been helpful in like cases, it was fully warranted in finding that the partnership was engaged in the business of building houses for sale and that it did not in 1944 or 1945 enlarge or change its business to that of renting residential property or enter into a new business of renting property to defense workers. Under the circumstances it is clear that there is sufficient evidence in the record that the 69 multiple-unit houses were held primarily for sale to customers in the ordinary course of the part-

nership's business within the meaning of Section 117 (a) and (j) of the Code.

#### ARGUMENT

### **There Is Ample Evidence in the Record to Support the Tax Court's Finding That the 69 Multiple-unit Houses in Question Were Held by the Taxpayers in 1944 and 1945 Primarily for Sale to Customers in the Ordinary Course of the Partnership's Business Within the Meaning of Section 117 (a) and (j) of the Internal Revenue Code**

In 1945, the taxpayers sold 69 multiple-unit houses located in the area called Beautiful Glenwood which is near Burbank, California. The taxpayers reported the \$238,329 in profits they realized from the sales in their returns for 1945 and 1946 on the installment method as long-term capital gain. On September 27, 1947, the Commissioner determined deficiencies against the taxpayers for the years 1945 and 1946, on the ground that the profits derived from the sale of the 69 multiple-unit houses constituted ordinary income rather than capital gain since the units were held primarily for sale to customers in the ordinary course of the taxpayers' business. The taxpayers petitioned the Tax Court for a redetermination of the assessed deficiencies and that court found (R. 34-35):

Prior to and during the taxable years, Security Construction Company—the partnership—was engaged in the business of building houses for sale. It did not, in 1944 or 1945, enlarge or change its business to that of renting residential property for investment, or enter into a new business of renting property to defense workers.

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The 69 multiple-unit houses were not capital assets. The gain realized in 1945 and 1946, on the installment basis, from the sale thereof in 1945 constituted ordinary income rather than long-term capital gain.

It concluded that the 69 multiple-unit houses were held primarily for sale to customers in the ordinary course of the partnership's business of building and selling houses in 1944 and 1945, and were not at any time capital assets and sustained the Commissioners' deficiency determination.

This Court has been confronted with the question of whether property was "property held \* \* \* primarily for sale to customers in the ordinary course of his trade or business," under subsections (a) and (j) of Section 117, Internal Revenue Code (Appendix, *infra*), in an impressive array of cases. *McGah v. Commissioner*, 210 F. 2d 769; *Jones v. Commissioner*, 209 F. 2d 415; *Palos Verdes Corp. v. United States*, 201 F. 2d 256; *McGah v. Commissioner*, 193 F. 2d 662; *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263; *Rubino v. Commissioner*, 186 F. 2d 304, certiorari denied, 342 U. S. 814; *Field v. Commissioner*, 180 F. 2d 170; *Ehrman v. Commissioner*, 120 F. 2d 607; *Richards v. Commissioner*, 81 F. 2d 369. The question to be decided is essentially one of fact and a trial court's finding that property was so held by a taxpayer is not to be disturbed unless clearly erroneous. *Rollingwood Corp. v. Commissioner*, *supra*; *Rubino v. Commissioner*, *supra*.

As this Court and others have often pointed out, there is no fixed formula or rule of thumb for determining whether property sold by a taxpayer was held by

him primarily for sale to customers in the ordinary course of business. Each case must, in the last analysis, rest on its own peculiar facts. There are, however, certain factors which have been recognized as helpful guides in ascertaining the correct result. Among those are (1) the purpose for which the property was acquired (2) the frequency and continuity of sales as opposed to isolated transactions (3) the activities of the taxpayer and those acting in his behalf or under his direction in conducting a sales campaign either through advertisements or the employment of real estate agents, and (4) the substantiality of the transactions.

In the case at bar, taxpayers, well aware of the aforementioned factors, base their argument on the contention that during the years involved here they were engaged in the dual activity of building houses for sale and investment purposes. (Br. 17-30, 37-41.) While it is, of course, possible to be engaged in the conduct of more than one business, each case in the end must be judged on its own facts. Indeed, as this Court pointed out in the *Rollingwood* case, *supra* (p. 266), most cases dealing with the problem of whether property was held primarily for sale to customers in the ordinary course of his trade or business involve a situation where the taxpayer is engaged in some activity apart from his usual occupation and the question is whether that activity constitutes a business. Here, however, we are not confronted with such a situation for the taxpayers did not engage in a different activity apart from their usual business occupation of building houses for sale.

We maintain, as the Tax Court found, that the housing units were built with the intention of selling them

to customers even though they were being rented until favorable conditions warranted sales. There is ample evidence to sustain the Tax Court's finding that the taxpayers held the 69 units in question during 1944 and 1945 "primarily for sale to customers in the ordinary course of the partnership's business of building and selling houses" (R. 34-35) within the meaning of Section 117 (j) of the Code.

The record discloses that the partnership, involved in the instant case, was in active existence from May 21, 1942, until about the first of April, 1946. During that period of time it built and sold 324 houses, of which 253 were single-unit houses and 71 multiple-unit houses. A breakdown of the foregoing total, 21 houses sold in 1942, 109 in 1943, 109 in 1944, 69 in 1945 and 16 in 1946, effectively disposes of any contention that might be advanced that the sales under consideration here were isolated or casual transactions.<sup>3</sup> With the sole exception of the 69 multiple-unit houses none of the houses were rented but all were sold immediately upon their completion and the gain resulting from their sale was reported by the taxpayers as ordinary income.<sup>4</sup> (R. 20-21, 53-55, 267-268.)

A close scrutiny of the reasons underlying the construction of the apartments demonstrates even more

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<sup>3</sup> The 69 multiple units were sold over a period of only 10 months, the sales starting approximately 6 months after the last unit was completed. (R. 26, 29.)

<sup>4</sup> It is noteworthy that from December, 1941, until December, 1951, taxpayers, through their various corporations and partnerships, constructed at least 1,332 houses, of which number 1,225 were single-unit houses sold immediately upon completion; 107 were multiple-unit houses of which number only the 11 built by the *Orange Gardens Corporation* were held as rental property on December 5, 1951. The latter apartments are located 35 miles from the 69 units in question here. (R. 31-33, 327-344.)



clearly that the partnership was at all times in the business of building houses for sale and negates any idea that the 69 multiple-unit houses were erected as long term investment property. Due to wartime restrictions the partnership in 1943 had to obtain priorities for construction materials in order to continue its business of building houses. Upon inquiry Edgar M. Cohn was informed by the F.H.A. that priorities were only being granted for the construction of multiple-unit houses. (R. 21-22, 215-216, 250-251.) Therefore, the original intent of the partnership to build single houses was temporarily shelved and an application was filed for priorities to build 56 multiple-unit houses on tract 13170. The application was granted on July 17, 1943. However, before construction began the F. H. A. on August 25, 1943, enlarged the classification of defense housing to include single-unit houses and amended its basic order (N.H.A. Order No. 60-3 (R. 175-183)) by means of N.H.A. General Order No. 60-3B (R. 184-194) which permitted a builder to sell one-third of its houses to defense workers, without first renting them provided the sale was made within 15 days after completion (R. 23-24, 250-251).

Subsequent to the above mentioned amendment, the partnership in September, 1943 applied for priorities to build houses on tract 13171, and its application was approved in the middle of December, 1945.<sup>5</sup> Taxpayers at that time knew that by treating the construction on tracts 13170 and 13171 as one project they would be able to sell one-third of the total units upon completion

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<sup>5</sup> Taxpayers however did not purchase tract 13170 or 13171 until an appreciable time after priorities had been granted to build on the individual tracts. (R. 23-26, 53-54, 251-253.)

to war workers. Moreover, they also realized that in order to construct the 109 single-unit houses they were required to build the 69 multiple-unit houses here in question.<sup>6</sup> (R. 25-26, 253-254, 265-266.) By erecting the multiple-unit houses the partnership did not remove itself from the business of building houses for sale for the 69 houses could be sold upon completion to non-occupants subject, however, to the then prevailing restrictions. The partnership was fully aware of this for Edgar Cohn testified that the 69 houses could be sold at any time. (R. 306.) If actualities are to be considered, the rental of the units rather than precluding their sale made the property even more desirable in the eyes of potential buyers for the latter on purchase need only collect the rents from the tenants.

As we have seen the evidence points convincingly to the fact that 69 multiple-unit houses were constructed by the partnership in the ordinary course of its business of building houses for sale. Therefore, in the light of the foregoing, there is ample evidence to support the Tax Court's finding that (R. 40):

At best, the evidence, in our opinion shows merely a dual purpose, namely, to rent the multiple-unit houses until such time as it would be profitable and convenient to sell them. In that situation it must be concluded that "one of the essential purposes (in acquiring or holding the houses) is the purpose of sale," *Rollingwood Corp. v. Commis-*

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<sup>6</sup> As of December 17, 1943, the partnership was authorized to construct 178 houses comprising 319 units. It appears that the N.H.A. gave its approval to the partnership to treat the 109 single family houses as one-third and the 210 units contained in the 69 multiple-unit houses as two-thirds of the project to be erected on tracts 13170 and 13171. (R. 25-26.)

*sioner, supra*, and the profit on sale cannot be treated as capital gain.

Cf. *McGah v. Commissioner*, 210 F. 2d, p. 771.

Cumulative support for the Tax Court's finding that the partnership was in the business of building and selling houses in 1944 and 1945, is to be found in the efforts employed by the partnership to make sales which is indistinguishable from that employed by people engaged in the business of selling real estate. The pattern established by the partnership in selling its other houses was adhered to here. It employed real estate brokers who were guaranteed a certain specified amount or percentage of the amount received for the houses. The partnership's desire to sell the 69 multiple-unit houses was so intense that it changed real estate brokers in 1945 when taxpayers considered that sales were moving at too slow a pace. (R. 28-29, 229, 275-276.)

While taxpayers admit that advertisements were placed in newspapers, advertising their single-unit houses for sale (R. 261), the advertising of the 69 multiple-unit houses, outside of that done by the brokers (R. 229) was confined to two billboards adjacent to the sales office owned and maintained by the partnership (R. 260). The sales office was located next to the partnership's office on a plot of ground bordering tract 13170 on which 56 of the units were erected. (R. 259-260, 311.) This sales office was occupied rent-free by the brokers selling the apartment building and it was their custom to have a man on duty there a considerable amount of the time. (R. 28, 276-278.) It is also important to note that one of the partners, Edger Cohn, assisted the brokers at various times in selling the 69 multiple-unit buildings. (R. 264-265, 281.) As a result,

we submit that the partnership was at all times in the business of building and selling real estate.

Taxpayers made an argument (Br. 30-33) to the effect that they as prudent investors only liquidated their investment out of fear that they would lose many of their tenants when Lockheed Aircraft cut production and employees. This Court considered a similar argument in *Palos Verdes Corp. v. Commissioner, supra*, p. 259, and rejected it as being without substance. The Court said:

The evidence indicates to us that the owner was not in the real estate business by choice, but because it offered the way to dispose of the property which, to use an old expression, "was eating its head off" through expenses of holding it. *The owner did, however, resort to a method of disposal which in fact required that the property be submitted to customers in the ordinary course of trade or business of real estate.* (Italics added.)

See *Home Co. v. Commissioner*, 212 F. 2d 637 (C. A. 10th);<sup>7</sup> and *Dillon v. Commissioner* (C. A. 8th), decided June 4, 1954 (1954 C.C.H., par. 9429).

Also indicating that the partnership was engaged only in the business of building and selling houses as contrasted to taxpayers' contention that the partnership

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<sup>7</sup> The Tenth Circuit said in the *Home Co.* case, *supra* (p. 641):

One may, of course, liquidate a capital asset. To do so it is necessary to sell. The sale may be conducted in the most advantageous manner to the seller and he will not lose the benefits of the capital gain provision of the statute, unless he enters the real estate business and carries on the sale in the manner in which such a business is ordinarily conducted. In that event, the liquidation constitutes a business and a sale in the ordinary course of such a business and the preferred tax status is lost.

was engaged in a dual business of building houses for sale and investment is the substantiality of its transactions. As we have seen the partnership's transactions were substantial in number for it sold all the buildings that it erected. Further, they were substantial from the standpoint of financial return. While it is true that the "disparity between income from sales and from rentals is not controlling" (*Delsing v. United States*, 186 F. 2d 59, 61 (C. A. 5th)), ordinarily a taxpayer whose primary interest in real estate is investment income, or rentals, would be expected to receive more income from rentals than from sales. Accordingly, one of the tests sometimes applied to distinguish an investor from a dealer is a comparison of rental income to sales income.

In the case at bar the partnership during the period of its active existence received the following profits from sales and rentals (R. 21, 352-362):

Year	Profits from Sales	Net Rentals
1942	\$15,035	—
1943	73,349	—
1944	111,436	\$28,793
1945	238,329	8,425
1946	64,835	745

In 1944 and 1945, the partnership received net rental income of \$37,218 from the 69 multiple-unit houses. The partnership realized a profit of \$238,329 from the sale of the aforementioned buildings in 1945, after deducting all expenses not allocated to rentals in the 1945 partnership return. (R. 118-128.) The ratio of profits of sales income to total rental income from the 69 multiples is therefore six to one. In the taxable year 1945,

the ratio net profits of \$238,329 from sales, to \$8,425 for rentals was of 28 to 1. The overwhelming ratio of sales income to rental income during the partnership's active existence shows quite conclusively we believe that all the housing units were held primarily for sale to customers in the ordinary course of its business and that the rental of the 69 housing units was only incidental thereto.

Taxpayers' reliance upon the decisions of this Court in the *McGah* cases, *supra*; and *Victory Housing No. 2 v. Commissioner*, 205 F. 2d 371 (C. A. 10th); and in *Dillon v. Commissioner*, *supra*, is misplaced due to obvious factual differences. The *McGah* cases are distinguishable from the instant case in that (1) there from the very inception of the partnership business the idea of constructing houses for rental purposes was the dominating and controlling motive; and (2) there the decision to sell the rental units was not voluntarily made but was the result of a bank's demand for payment of part of the money owed it by the taxpayer.

In the *Victory Housing* case, taxpayer was not engaged in the business of constructing units for sale to customers, as here, but rather from its very formation was engaged solely in the rental business. There, taxpayer did not actively engage in the real estate business as was done by taxpayers in the case at bar but only sold the houses when desiring purchasers came to it, inquired about them and requested to make a purchase.

Here, the fact that the partnership admittedly built the 69 multiple-unit houses so that it could build and sell the 109 single-unit houses plus the fact that the Tax Court found on the strength of the whole record

that the apartments were during 1944 and 1945 held for sale to customers, distinguishes the instant proceeding from the *Dillon* case, *supra*, where the Tax Court found that the houses were built and held for rental purposes up to the date they were sold, and the record failed to disclose that taxpayer's business was other than the liquidation of his ownership in the 20 rental units.

As we have previously said, the question of whether or not property was held primarily for sale to customers in the ordinary course of the partnership's business is a question of ultimate fact, each case having in the last analysis to turn on its own peculiar facts. Furthermore, it is not a question of whether one case can be distinguished from another but rather whether there is sufficient evidence to support the Tax Court's finding that the partnership held the 69 units in question primarily for sale to customers in the ordinary course of its business.

Under the circumstances, it is clear that the Tax Court has not erred in this case. It considered the crucial question as being whether at the time of sale the partnership held the 69 multiple-unit houses in question primarily for sale to customers in the ordinary course of its trade or business within the meaning of Section 117 (j) of the Code. Considering the attending facts and circumstances, the Tax Court was amply justified in finding that the partnership at all times so held the apartments and, accordingly, in deciding that the gain realized on their sale was taxable as ordinary income rather than as long-term capital gain.

## CONCLUSION

The decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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AUGUST, 1954.



## APPENDIX

## Internal Revenue Code:

## SEC. 22. GROSS INCOME.

(a) *General Definition.*—“Gross income” includes gains, profits, and income \* \* \* from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; \* \* \* or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

\* \* \* \*

(26 U.S.C. 1952 ed., Sec. 22.)

## SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1);

\* \* \* \*

(j) [as added by Sec. 151 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term “property used in the trade or business” means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) *General rule.*—If, during the taxable year, the recognized gains upon sale or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such

sales exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. \* \* \*

\* \* \* \*

(26 U.S.C. 1952 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.117-1. *Meaning of Terms.*—The term “capital assets” includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a “capital asset,” the period for which held is immaterial. .

The exclusion from the term “capital assets” of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23 (1) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117 (b) and losses from such transactions are not subject to the limitations on losses provided in section 117 (d), except that under section 117 (j) the gains and losses from the sale or exchange of such property held for more than six months may

be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See sections 29.117-7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23 (1) prior to its amendment by the Revenue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117 (b), (c), and (d). The term "ordinary net income" as used in these regulations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

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